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No. 99-1883

In the Supreme Court of the United States

R&W TECHNICAL SERVICES, LTD.
AND GREGORY M. REAGAN, PETITIONERS

v.

COMMODITY FUTURES TRADING COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE COMMODITY FUTURES TRADING COMMISSION IN OPPOSITION

SETH P. WAXMAN
Solicitor General
Counsel of Record
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

C. ROBERT PAUL
General Counsel

GLYNN L. MAYS
Senior Assistant General Counsel

MICHAEL J. GARAWSKI
Attorney
Commodity Futures Trading Commission
Washington, D.C. 20581

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QUESTIONS PRESENTED

1. Whether petitioners were "commodity trading advisor[s]" under Section 1a(5) of the Commodity Exchange Act, 7 U.S.C. 1a(5).

2. Whether petitioners made misrepresentations concerning the performance and use of their futures-trading system "in connection with" any order to make, or the making of, futures contracts, in violation of Section 4b(a) of the Commodity Exchange Act, 7 U.S.C. 6b(a).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A48) is reported at 205 F.3d 165. The opinion and order of the Commodity Futures Trading Commission (Pet. App. A50-A174) is unofficially reported at [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,582.

JURISDICTION

The judgment of the court of appeals was entered on February 24, 2000. The petition for a writ of certiorari was filed on May 24, 2000. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. From April 1993 through March 1996, petitioners sold computer software that generated trading signals for commodity futures contracts. Pet. App. A3, A55. Petitioners' trading systems incorporated mathematical formulas that purportedly identified exploitable price trends. Using those formulas, the software analyzed current price data from certain commodity markets and produced trading recommendations that the user was advised to act upon at the opening of trading on the following day. *Id.* at A3, A56-A61.

Petitioners solicited members of the public to purchase their software primarily through advertisements in *Futures* magazine. Pet. App. A63. In those advertisements and other promotional materials, petitioners claimed that the software consistently had generated spectacular profits. *Id.* at A3, A64-A66. Petitioners bolstered such claims of actual trading profits by representations that their profits data were based on "account balance[s]," "bank balance[s]," and "certified" trading results. *Id.* at A3, A66 n.14. The promotional materials also represented that petitioners sold the software to "increase [petitioners'] own trading capital." *Id.* at A66-A67. Contrary to those representations, however, the trading results set forth in the advertisements were based on hypothetical, simulated trading results. *Id.* at A4, A68-A71.

On March 19, 1996, the Commission brought an administrative enforcement action against petitioners charging, *inter alia*, that they engaged in fraud in the solicitation of customers, in violation of 7 U.S.C. 6b(a)(i) and (iii); that they engaged in fraudulent sales practices and fraudulent advertising, in violation of 7 U.S.C. 6o(1) and CFTC Rule 4.41(a), 17 C.F.R. 4.41(a); and that they

failed to register as commodity trading advisors, in violation of 7 U.S.C. 6m(1). Pet. App. A51-A53.

On December 1, 1997, an administrative law judge (ALJ) issued an initial decision finding that petitioners were liable for all but one of the alleged violations. Pet. App. A81-A84.[1] The ALJ ordered that petitioners cease and desist from violating the Commodity Exchange Act (the Act) and the Commission's regulations, and that petitioners jointly and severally pay civil monetary penalties in the amount of $7,125,000. *Id.* at A84-A87.

On March 16, 1999, the Commission affirmed in part, modified in part and vacated in part the ALJ's decision. Pet. App. A49-A174. The Commission found that petitioners intentionally misrepresented hypothetical trading results as actual trading results, misrepresented their actual use of their trading systems, and misrepresented the risks of futures trading by making exaggerated predictions of profit along with guarantees of profitability. The Commission affirmed the ALJ's conclusion that petitioners made those misrepresentations "in connection with" any order to make futures contracts, in violation of 7 U.S.C. 6b(a). Pet. App. A124-A145. After concluding that petitioners fell "within the plain meaning" of the statutory definition of commodity trading advisors (*id.* at A108-A124), the Commission also affirmed the ALJ's conclusion that petitioners engaged in fraud and deceptive advertising as commodity trading advisors, in violation of 7 U.S.C. 6*o*(1) and CFTC Rule 4.41(a), 17 C.F.R. 4.41(a). Pet. App. A145-A148.

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[1] The ALJ found that petitioner R&W Technical Services, Ltd., had not violated the record-production requirements under 7 U.S.C. 6n(3)(A). Pet. App. A83.

The Commission ordered that petitioners cease and desist from violating 7 U.S.C. 6b and 6*o* and CFTC Rule 4.41(a), 17 C.F.R. 4.41(a), and imposed civil monetary penalties in the reduced amount of $2,375,000. Pet. App. A157-A158, A162-A171. Viewing the case "primarily as an action to enforce the antifraud provisions of the Act and [its] regulations," however, the Commission found that it was unnecessary to reach the merits of the charges of registration and record-production violations. The Commission therefore vacated the ALJ's cease and desist order pertaining to those allegations. *Id.* at A154, A158 n.57.

2. The court of appeals affirmed the Commission's finding of liability, but reversed and remanded the Commission's imposition of a monetary penalty. Pet. App. A1-A48. The court first affirmed the Commission's liability findings under 7 U.S.C. 6b(a), which prohibits any person from defrauding another person "in connection with" an order to make, or the making of, a commodity futures contract. Pet. App. A6-A24. In reaching that conclusion, the court of appeals deferred to the Commission's interpretation that fraud in the sale of investment advice is "in connection with" the sale of a commodity futures contract "if the fraud relates to the risk of the trading and the primary purpose of purchasing the advice is to execute trades." *Id.* at A20. The court therefore held that it was "not unreasonable" for the Commission to conclude that petitioners' misrepresentations to customers "regarding the reliability of a system whose only intended use was as a means of selecting commodity futures contracts" occurred "in connection with" the making of commodity futures contracts. *Id.* at A24.

The court of appeals also affirmed the Commission's findings that petitioners violated 7 U.S.C. 6*o* and CFTC

Rule 4.41(a), 17 C.F.R. 4.41(a), which prohibit a "commodity trading advisor" from defrauding clients and prospective clients. Pet. App. A24-A38. The court observed (*id.* at A25) that 7 U.S.C. 1a(5)(A) defines a "commodity trading advisor" as "any person who * * * for compensation or profit, engages in the business of advising others, either directly or through publications, writing, or electronic media, as to the value of or the advisability of trading in" commodity futures contracts. The court also observed (Pet. App. A25) that although the term "commodity trading advisor" does not include any "publisher or producer of any print or electronic data of general and regular dissemination," that exclusion applies only if "the furnishing of such services * * * is solely incidental to the conduct of their business or profession." 7 U.S.C. 1a(5)(B)(iv) and (C).

The court of appeals rejected petitioners' argument that the reference in Section 1a(5)(C) to "such services" refers only to "personalized advisory services." It explained that "[t]he plain language" of the Act contains no hint that the statutory reference to direct or indirect advisory services is limited to personal advisory services. Pet. App. A26. In the alternative, the court held that the exclusion in Section 1a(5)(B)(iv) did not apply to petitioners' publications, because petitioners' software was neither "generally" nor "regularly" disseminated, as required by the exclusion. *Id.* at A28-A29.[2]

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[2] The court of appeals also held that petitioners' misrepresentations were "material" under 7 U.S.C. 6b(a) (Pet. App. A6-A12), and that petitioners waived their contention that their advertising did not defraud potential "clients" within the meaning of 7 U.S.C. 6*o* and CFTC Rule 4.41(a), 17 C.F.R. 4.41(a) (Pet. App. A35-A38). Petitioners do not challenge those rulings in this Court.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is not warranted.

1. a. Petitioners argue (Pet. 5-9) that they were not "commodity trading advisor[s]" within the meaning of the Act because they fell within the exception in 7 U.S.C. 1a(5)(B)(iv) for publishers of print or electronic data. That contention lacks merit.

The Act broadly defines a "commodity trading advisor" as any person who "engages in the business of *advising others, either directly or through publications, writings, or electronic media,*" as to the advisability of trading in futures contracts. 7 U.S.C. 1a(5)(A)(i) (emphasis added). Section 1a(5)(B)(iv) provides that "[s]ubject to subparagraph (C), the term 'commodity trading advisor' does not include * * * the publisher * * * of any print or electronic data of general and regular dissemination." 7 U.S.C. 1a(5)(B)(iv). Section 1a(5)(C), entitled "Incidental services," in turn provides that "[s]ubparagraph (B) shall apply only if the furnishing of such services by persons referred to in subparagraph (B) is solely incidental to the conduct of their business or profession." 7 U.S.C. 1a(5)(C).

As the court of appeals correctly concluded, the plain import of those provisions is that the publisher exception is available only if the advisory services referenced in Section 1a(5)(A) are solely incidental to the publisher's business. See Pet. App. A26 ("Absent any other distinctions, the later reference [in Section 1a(5)(C)] to 'such services' can only refer to both the direct and indirect provision of advisory services."). Petitioners therefore do not fall within the publisher

exception, because their advisory activities were not "solely incidental" to their exclusive business of marketing software that advises users concerning commodity futures trading. See *id.* at A115.

Relying on this Court's decision in *Lowe* v. *SEC*, 472 U.S. 181 (1985), which held that the Investment Advisers Act of 1940, 15 U.S.C. 80b-2(a)(11), did not apply to impersonal investment advisers, petitioners argue (Pet. 6-9) that the phrase "such services" in Section 1a(5)(C) refers only to "personalized" advisory services. They further argue that their limiting construction is necessary to avoid any constitutional doubt about the Commodity Exchange Act's registration requirements applicable to commodity trading advisors. See 7 U.S.C. 6m(1). The court of appeals properly rejected those contentions. Pet. App. A30-A34.

As an initial matter, the Court in *Lowe* construed a different statute that excluded from the definition of an investment adviser a "publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation." See 472 U.S. at 204 (citing 15 U.S.C. 80b-2(a)(11)(D)). By contrast, here the Commodity Exchange Act's exclusion for publishers applies only if the publisher's rendering of commodity trading advice is "solely incidental" to the publisher's business. 7 U.S.C. 1a(5)(C). Thus, the exclusion for publishers from the definition of a commodity trading advisor is, on its face, narrower than the exclusion addressed in *Lowe*.

Moreover, there is no reason to ignore the plain text of Section 1a(5)(C) to avoid construing the Act to infringe upon petitioners' First Amendment rights. The statutory definition of a "commodity trading advisor" itself raises no First Amendment concerns,

and petitioners do not and cannot claim any First Amendment interest in their fraudulent advertising. See Pet. App. A33 (citing *Lowe*, 472 U.S. at 225 (White, J., concurring); *Zauderer* v. *Office of Disciplinary Counsel*, 471 U.S. 626, 651 (1985); *Village of Schaumburg* v. *Citizens for a Better Env't*, 444 U.S. 620, 637-638 (1980); and *Schneider* v. *State*, 308 U.S. 147, 164 (1939)).

Petitioners' only constitutional claim relates to the Act's registration requirements applicable to commodity trading advisors. Pet. 8-9.[3] The Act's registration provisions, however, are not at issue in this case, because the Commission did not find that petitioners violated the registration requirements. See Pet. App. A32, A154, A158 n.57. Thus, "even if the registration requirements are unconstitutional, the rest of the [Commodity Exchange Act] would remain intact under [the] severability clause [in 7 U.S.C. 17]." *Id.* at

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[3] Two district courts have concluded that the Act's registration requirements may not constitutionally be applied to require publishers of "impersonal" commodity trading advice to register with the CFTC. *Taucher* v. *Born*, 53 F. Supp. 2d 464, 481-482 (D.D.C. 1999), dismissed, No. 99-5293, 2000 WL 516081 (D.C. Cir. Mar. 28, 2000); *Commodity Trend Serv., Inc.* v. *CFTC*, No. 97 C 2362, 1999 WL 965962, at *12-*14 (N.D. Ill. Sept. 29, 1999), appeal pending on other grounds, No. 99-4142 (7th Cir.). The Commission thereafter adopted CFTC Rule 4.14(a)(9), 65 Fed. Reg. 12,938 (2000) (to be codified at 17 C.F.R. 4.14(a)(9)), which provides regulatory relief from the registration requirement for, *inter alia*, the types of publishers at issue in those cases. The language of the rule and its preamble suggest that, given the record in this case, petitioners also would be exempt from the Act's registration requirement. CFTC Rule 4.14(a)(9)(ii) (to be codified at 17 C.F.R. 4.14(a)(9)(ii)); see also 65 Fed. Reg. at 12,941 (Example B).

A32. Nor does petitioners' statutory claim, on which there is no circuit conflict, warrant this court's review.[4]

b. In any event, petitioners do not contest the court of appeals' alternative holding (Pet. App. A28-A29) that petitioners do not qualify for the publisher exclusion because their "software publishing was neither 'generally' nor 'regularly' disseminated," as required by Section 1a(5)(B)(iv). This Court in *Lowe*, 472 U.S. at 209, explained that the term "regular" under the broad exception for publishers in the Investment Advisers Act of 1940 requires the absence of any "indication that [the publications] have been timed to specific market activity." Here, the trading signals in petitioners' software were tied to price trends occurring in the futures markets. See Pet. App. A28 ("[T]he petitioners' recommendations were provided by software that was programmed to 'speak' only when certain market conditions were met."). Moreover, petitioners' software was not "generally" disseminated, because "petitioners advertised that the software would only be sold in limited numbers." *Id.* at A29; see also *id.* at A113.

2. a. Petitioners further argue that they cannot be liable for engaging in fraud "in connection with any order to make, or the making of, any [futures contract]," 7 U.S.C. 6b(a), because their misrepresentations were not made "in connection with any individual

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[4] Petitioners concede (Pet. 7) that the decision below does not conflict with any appellate decision. Although they point out that one district court has concluded that Section 1a(5) excludes publishers of impersonal commodity trading advice, see *Ginsburg* v. *Agora, Inc.*, 915 F. Supp. 733, 737-738 (D. Md. 1995), the existence of that conflicting district court decision does not warrant this Court's review. Robert L. Stern et al., *Supreme Court Practice* § 4.8, at 178 (7th ed. 1993).

or specific commodity futures transactions." Pet. 11. That contention, too, lacks merit.

Although petitioners did not execute trades for customers, the Commission reasonably viewed petitioners' fraudulent sales of commodity trading advice to be "in connection with" commodity trading, because "the fraud relates to the risk of the trading and the primary purpose of purchasing the advice is to execute trades." Pet. App. A20. As the court of appeals explained, "petitioners' advertising claims misrepresented the fundamental risk associated with commodity futures investments and trading systems." *Id.* at A17. Moreover, petitioners' "expensive software had no purpose except as a device for choosing which trades to make," and petitioners "necessarily expected their customers to make trades." *Id.* at A20. Finally, petitioners "misled potential purchasers of their system concerning trading profits and trading risks in order to induce customers to trade, and there is ample evidence to show that they did trade." *Id.* at A21-A22. The court of appeals therefore correctly concluded that "defraud[ing] customers regarding the reliability of a system whose only intended use was a means of selecting commodity futures contracts" is conduct that occurs "in connection with" the making of commodity futures contracts. *Id.* at A24.

Petitioners err in suggesting (Pet. 12) that the court of appeals' holding conflicts with *United States* v. *O'Hagan*, 521 U.S. 642, 656 (1997). The Court in *O'Hagan* held that the phrase "in connection with" under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), was satisfied by allegations that an attorney, without disclosure to his principal, used misappropriated information to buy or sell securities. 521 U.S. at 656. In those circumstances, the Court

explained, "[t]he securities transaction and the breach of duty * * * coincide." *Ibid.* *O'Hagan* neither purports to define the limits of the "in connection with" requirement outside the misappropriation context nor suggests that the requirement would not be satisfied by fraudulent conduct that is calculated to cause its victims to engage in market trading.

b. Petitioners argue (Pet. 12-13) that the decision below conflicts with *Saxe* v. *E.F. Hutton & Co.*, 789 F.2d 105, 109-111 (2d Cir. 1986), and *Hirk* v. *Agri-Research Council, Inc.*, 561 F.2d 96, 103-104 (7th Cir. 1977). Contrary to petitioners' contention, however, neither of those decisions construed the "in connection with" requirement in Section 6b "to mean that the fraudulent misrepresentation must concern the fundamental nature of a particular order or sale of a futures contract, such that the fraud must involve the quality of or the risks associated with the investment." Pet. 13. Rather, in *Saxe*, 789 F.2d at 110-111, the Second Circuit simply held that the "in connection with" requirement was satisfied when an E.F. Hutton employee convinced a customer to open a trading account with a commodity trading advisor by misrepresenting the advisor's abilities and the quality and degree of risk in the advisor's trading program. See Pet. App. A19 ("In the instant case, the petitioners' misrepresentations regarding the reliability of their system are analogous to the broker in *Saxe* misrepresenting another broker's track record.").

Similarly, in *Hirk*, 561 F.2d at 103, the Seventh Circuit found that the "in connection with" requirement was satisfied when securities brokers solicited an investor to open a discretionary futures trading account with a company by misrepresenting the profitability of the company and its managed accounts, the competency

and experience of the company's analysts, and the total amount that the investor could lose. The court of appeals specifically rejected the notion that the "broad" phrase "in connection with" requires "conduct related to persuading a customer to purchase a commodities futures contract or in reporting to a customer the status of the contract or the trading." *Ibid.* Thus, there is no conflict in the circuits warranting this Court's review. See Pet. App. A24 (observing that the Commission's interpretation of the "in connection with" requirement "does not conflict with any earlier interpretation by the federal courts").

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

SETH P. WAXMAN
Solicitor General

C. ROBERT PAUL
General Counsel
GLYNN L. MAYS
Senior Assistant General Counsel
MICHAEL J. GARAWSKI
Attorney
Commodity Futures Trading Commission

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